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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation	)	CC Docket No. 92-135

COMMENTS OF AMERICAN TELEPHONE AND TELEGRAPH COMPANY

American Telephone and Telegraph Company ("AT&T") respectfully submits the following Comments in response to the Commission's July 17, 1992 Notice of Proposed Rule Making ("NPRM").

The NPRM (¶ 1) "continues the examination of improved regulatory regimes for small and mid-sized local exchange carriers ("LECs") as announced in the LEC Price Caps Order."[1] The NPRM (¶ 4) proposes three types of regulatory reforms for small and mid-size LECs: (1) an optional incentive regulation ("OIR") plan for rate of return carriers that is designed as an intermediate step to price cap regulation; (2) a modification of the Commission's

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1 Policy and Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd. 6786, 6827 (1990) and Erratum, 5 FCC Rcd. 7664 (1990) ("LEC Price Caps Order"), modified on recon., 6 FCC Rcd. 2637 (1991), petitions for further recon. dism., 6 FCC Rcd. 742(1991), further modif. on recon., 6 FCC Rcd 4524 (1991) ("ONA Part 69 Order"), petitions for recon. of ONA Part 69 Order pending, appeal docketed, D.C. PSC v. FCC, No. 91-1279 (D.C. Cir. June 14, 1991).

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rules for extremely small LECs to allow their carrier common line ("CCL") rates, as well as their traffic sensitive rates, to be developed on the basis of historical costs; and (3) streamlining the basic rate of return regulation that would apply to companies not electing price caps or any of the optional regulatory plans proposed in the NPRM.

AT&T's interest in these proposals derives from the fact that they would affect the interstate access rates charged by LECs operating in rural and less densely populated areas. AT&T purchases significantly more access from these carriers than its interexchange competitors, in large part because the competitors have chosen not to serve these regions of the country.[2]

In general, AT&T supports the NPRM's proposals, because they should help to encourage small and mid-size LECs to reduce costs and increase the efficiency of their access operations, and to pass on a portion of that efficiency to their access customers in the form of lower rates. AT&T's comments are directed at certain aspects of the various proposals.

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2 Moreover, since the imposition of price caps on the larger LECs, their access rates have tended to stabilize or go down, while the rates charged by the smaller, non-price cap LECs have tended to increase. This makes it increasingly difficult for AT&T to maintain a nationwide geographically averaged price structure for its own services.

The OIR Plan

Under the proposed optional OIR plan (NPRM, ¶¶ 9-13) LECs would file access tariffs every two years; rates for each individual rate basket would be retargeted to the authorized rate of return based upon costs and demand established during an historical period; and an earnings band would be established that would extend from 100 basis points below the authorized rate of return to 100 basis points above the authorized rate of return. LECs would be permitted to file mid-term rate adjustments targeted to the lower earnings band. LECs choosing the OIR plan would base their tariff filings on historical base period cost of service studies, with related demand data for the same period.[3]

The OIR plan appears appropriate for small and mid-size LECs and should be adopted. The proposed earnings band and the requirement that tariffs remain in effect for two years give LECs the incentive to control costs, because cost increases would lessen their earnings. The retargeting of rates based on historical costs and demand provides a straightforward and verifiable methodology for revising rates prospectively and passing through a portion of

3 The historical demand would be adjusted based on the historical base period level of demand growth when used in deriving CCL rates.

experienced productivity to access prices. The OIR plan would also limit LECs' risks. Access rates would be retargeted biennially to the LECs' authorized rate of return, mid-term adjustments to the lower earnings band would be permitted, and LECs would retain the option to revert to traditional rate of return regulation.

The NPRM (¶ 14), however, also proposes to allow LECs, as part of the OIR plan, to include in their biennial tariff filings additional "known and measurable" costs that the LEC expects to incur in the prospective two-year tariff period, if such costs would otherwise cause the carrier to earn less than the minimum level.

This proposal is inappropriate and unnecessary. It would, in effect, guarantee the carriers an up-front reimbursement of potential, prospective costs that may or may not actually materialize during the two-year tariff period, rather than requiring the carriers subsequently to demonstrate in a mid-term filing that unanticipated costs have actually occurred that threaten to prevent the carrier from earning the minimum level. Thus, to the extent that "known and measurable" costs are included initially in a carrier's rates, the carrier's incentive to reduce costs through actual efficiencies is substantially diminished.

The proposal would also complicate the implementation of tariffs, contrary to the Commission's objective (NPRM, ¶¶ 3, 10, 15) to simplify the ratemaking process and reduce the administrative burdens on carriers and the Commission. For example, the proposal would permit tariffs to be based on a mixture of historical and prospective costs rather than historical costs alone. This would require that carriers submit -- and interested parties and the Commission analyze -- large quantities of expense and investment information.[4] Moreover, to guard against overforecasting of "known and measurable" changes, there would need to be some form of post-period audit to determine whether these changes actually occurred, at what magnitude, and whether access customers are entitled to refunds of excessive rates that were predicated on unrealized costs. This would significantly lengthen and complicate the tariff process.

In all events, permitting LECs to include "known and measurable" costs in their biennial tariffs is unnecessary in light of the Commission's proposal in the NPRM (¶ 12) to permit mid-term rate corrections for OIR LECs who demonstrate that actually realized changes in costs have caused their earnings to fall below the lower earnings band. This approach would protect LECs from inadequate earnings

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4 For example, if a LEC were to claim that a "known and measurable" cost would cause its rate of return to decline 200 basis points, it would be necessary for the LEC to provide information on the investment and rate base effects of this change, in addition to the simple expense, revenue, and tax effects.

while at the same time preserving the LECs' incentives under the OIR plan to become more efficient.[5]

The Sharing Mechanism

The NPRM (¶ 12) seeks comment on whether the Commission should, as part of the OIR plan, subject LEC earnings over the maximum earnings band to sharing requirements. AT&T supports such requirements, because they appropriately balance the need to give LECs additional incentives to increase their efficiency with the right of access customers to be charged just and reasonable rates. Sharing requirements for small and mid-size LECs would also maintain consistency between the regulatory scheme for these carriers and the existing regulatory scheme applicable to the larger, price cap LECs.

Any sharing mechanism should require that excess LEC earnings be returned directly to access customers rather than incorporated in future access tariff filings. Reducing subsequent rates does not necessarily return to customers the correct amounts of overearnings, because the quantity of

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5 AT&T also proposes that any LEC which selects OIR must file on the public record a tariff review plan ("TRP") which contains the historical cost and demand data underlying the proposed CCL, traffic sensitive, and special access rate elements. These data are routinely generated by the LECs and are essential to verify the reasonableness of the proposed rates and of the revenue benchmarks that the Commission proposes be used to establish LEC pricing flexibility and to introduce new services without full cost support. See NPRM, ¶¶ 16, 18.

access purchased in the future may differ from purchases during the period when the excessive rates were in effect. For example, during the period when a LEC's rates were excessive, an interexchange carrier may have purchased ten percent of a LEC's access minutes, but years later, when the LEC returns the excess to customers in the form of lower rates, that same interexchange carrier may purchase 25 percent of the LEC's access minutes. In short, future rate reductions would likely benefit disproportionately the customers of faster-growing IXCs rather than the customers of the IXCs whose payments actually caused the LEC to overearn.

This is of particular concern here, because many of the small and mid-size LECs that are the subject of this proceeding have yet to implement equal access, which historically has resulted in significant changes over time in the amounts of access purchased by individual competing IXCs. Moreover, under the Commission's proposal, the sharing may not be implemented until more than four years after the excessive rates were charged and paid, which likely would result in substantial disparities between which IXC's customers initially paid the excessive rates and which IXC's customers eventually receive the benefit of the sharing mechanism. Earnings above the higher earnings band therefore should be returned directly to the individual customers that purchased the access services.[6]

Derivation of CCL Rates

For small and mid-size LECs that choose to develop rates pursuant to the requirements of either OIR or Part 61.39 of the Commission's Rules, the NPRM (¶¶ 13, 34) proposes to extend those rules to the LECs' CCL rates. Specifically, the Commission suggests that a LEC's CCL demand be based on the historical CCL usage and the percentage growth in usage over the historical base period. The CCL demand for the prospective two-year tariff period "would [then] be determined by a simple extrapolation of [historical] base period demand increased by base period percent growth."

This proposal is sound and should be adopted. It appropriately captures prospective CCL demand growth by tying it to actual, historical growth rates rather than speculative projections by the LEC as to how demand will grow in the future. The proposal will also be simple to administer, because it will be based solely on verifiable rates of growth in the recent past and will not require

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6 AT&T additionally suggests that, to be consistent with the LEC price cap scheme, the rate of return and sharing amounts for small and mid-size LECs be based on the LEC's earnings at the total interstate level. When biennial tariffs are filed, each rate basket should be retargeted to the authorized rate of return.

elaborate studies of future economic and demographic trends that could affect demand for access services.

Requirements for Baseline Rate of Return Carriers

With respect to small and mid-size LECs that do not elect either price caps, the OIR plan, or Part 61.39 regulation and choose instead to file tariffs under Part 61.38 rate of return regulation, the NPRM (¶¶ 42-45) proposes to reduce the level of detail required to support tariff filings. For example, the Commission suggests that LEC baseline rate of return filings be made biennially rather than annually. This proposal should be adopted. Annual filings are not necessary for the small LECs that choose to remain under rate of return regulation, and biennial filings will reduce administrative costs for both the Commission and all other interested parties.

AT&T also supports the Commission's proposal (NPRM, ¶ 44) that small and mid-size rate-of-return LECs file projected cost and demand data "developed as simple extrapolations of historical costs and demand." Historical data are ascertainable and verifiable, and basing projections on extrapolations of historical trends is a straightforward and consistent forecasting methodology. This proposal, if adopted, will reduce the filing burdens of small and mid-size rate-of-return LECs and will simplify the overall tariff filing process.

WHEREFORE, for the reasons stated above, the Commission should adopt the proposals in the NPRM, subject to the modifications described herein.

Respectfully submitted,

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